

Minutes

House LRC Committee on Banking Law Amendments

April 22, 2014

The House LRC Committee on Banking Law Amendments met Tuesday, April 22, 2014 at 1 p.m. in Room 425 in the Legislative Office Building. Representative John Bell, Co-Chair of the Committee, presided during the meeting. Committee Members present were Representatives Jonathan Jordan, Co-Chair, Rob Bryan, Ken Goodman, Jon Hardister, Stephen M. Ross, and John Szoka. Staff counsel members in attendance were Karen Cochrane-Brown, Drupti Chauhan and Luke Gillenwater. The Assistant Sergeant-at-Arms that assisted the meeting were Warren Hawkins, Barry Moore and Reggie Sills.

The meeting convened at 1 p.m. After introductions were made by Representative Bell, he made a motion to approve the minutes that were posted online from the January 22, 2014 meeting which were seconded by Representative Szoka. The minutes were approved unanimously by voice vote.

After opening remarks by Representative Bell, Ray Grace, the Commissioner of Banks presented an overview of the 2014 Stakeholders' Meeting that took place on March 13, 2014 on the issues that relate to the Committee's charge. He noted there were approximately 20 stakeholders in attendance, and issues that were discussed were surety bonds, audited financial statements, membership on the State Banking Commission and mortgage assessments. A report of the meeting was prepared and copies have been made available to the Members for this presentation (see Attachment A).

Commissioner Grace briefly discussed the history of Surety Bonds (see pages 5-6, Attachment A). The stakeholders agreed that bonds are necessary but mortgage industry representatives would like lower bond requirements in order to reduce the cost of doing business and to avoid placing North Carolina at an unfair disadvantage with other states with regard to job creation. The bonding industry responded that the cost of a bond is based on the risk profile of the applicant with a cost range between 1-2% of the bond amount. A surety bond is a small line of business that rarely has state-specific rates but mainly country-wide rates, and also provides a screening and prequalification function because stronger applicants are bondable. Consumer advocates present support the current bond levels because the bonds protect consumers and the marketplace, and assures there are quality players in the marketplace. They don't consider 1% cost of a bond to be high when it comes to the potential loss to homeowners. The banking industry noted that NCGS 53-244.103 allows the Commissioner to waive surety bonds under certain circumstances and added if there is a \$750 cost on a \$75,000 bond and it can be utilized in the event of a claim, the surety bond is beneficial. He expressed concern that if the bond requirement is lowered, more risk is shifted to the purchaser of the loan. Commissioner Grace cautioned on over-reliance with comparison to other states within the region because some states have complimentary laws that may present an offset. During the discussion about surety bond

tails, all stakeholders appeared to agree that they are necessary. The tail of the bond refers to the time after a bond is cancelled or claims continue to be filed against the insurance policy for the period of the tail. The mortgage industry noted that North Carolina's five year tail is longer than most states in the region, and the cost associated with the tail is passed to the consumer so they would like it to be shortened. Consumer advocates suggested that the tail not be shortened and could be lengthened. They argued that the statute of limitations in North Carolina is ten years for some claims and shortening the tail would make it more difficult for some borrowers that have been harmed to recover their losses.

Commissioner Grace reviewed the discussion about Audited Financial Statements (see pages 11-15, Attachment A). The NC SAFE Act requires a minimum net worth of \$100,000 for mortgage lenders and servicers as well as audited financial statements. Mortgage brokers are required to have a certified statement of financial condition and a net worth requirement of \$25,000. NCCOB assesses the lender's responsibilities and the stability of their finances which becomes relevant in the case of a lender that either must make refunds to consumers or repurchase loans from investors. It was noted that 58% of NC licensees are FHA-approved, which are non-supervised lenders and correspondents for FHA and are required to have audited financial statements. NCCOB examiners have discovered that brokers sometimes have inflated their assets which is a concern. The mortgage industry representatives said that audited financial statements were costly to attain and are limited in value, and suggested that certified statements of financial condition would be a less costly option. It was noted that Freddie Mac, Fannie Mae, FHA and HUD frequently require financial statements from larger lenders before they are approved. There is a distinction between large and small lenders, and an audited financial statement is a snapshot of one day in the business. There is temptation for an owner to move the net worth if a business begins to slump financially. North Carolina has the backstop of a surety bond requirement and state law has a requirement of warehouse line of credit. Consumer advocates noted that financial statements protect consumers and having a standardized review of the economic health is beneficial. NCCOB believes audited financial statements provide a higher level of confidence and gives the consumer a forward, ongoing look at the financial condition. The amount of refunds to consumers supports the knowledge requirement of net worth of a business.

Commissioner Grace reviewed the discussion of Membership on the State Banking Commission (see pages 15-17, Attachment A). None of the attendees objected to adding a mortgage industry representative to the State Banking Commission. A representative from the mortgage industry said the industry doesn't want to take seats away from any entity that currently has a seat on the Banking Commission, and proposed adding a seat for a member representing the non-depository mortgage originators and another seat for a public member so that the public members would retain a majority on the Commission. It was noted that the definition of a public member would need to be corrected in Chapter 53C if new members are added.

In his final review of the stakeholder's meeting, Commissioner Grace reviewed the discussion of mortgage assessments (see pages 17-19, Attachment A). The NCCOB hasn't been able to meet the full cost of regulating the mortgage industry through fee assessments so banks have been subsidizing the fee structure and have determined a different funding structure is needed. The mortgage assessment tier structure which is similar to the bank assessment structure was derived from discussions with stakeholders from the mortgage industry during 2011-2012. If the assessments are successful, there would be a 20% refund to the mortgage industry because the goal is to cover the cost of operating the agency and not make a profit. It was noted that the industry is faced with the prospect if the regulation of the industry was not adequately funded, another regulator would step in. The industries that are most affected by the assessments continue to discuss alternatives to the tier structure.

Robert Duke, Corporate Counsel for The Surety & Fidelity Association of America (which acts as a trade and statistical agent/advisory association) presented an overview of the surety bond requirement that is contained in the NC SAFE Act. The majority of surety bonds are written in North Carolina by SFA members. They collect and report premium and loss experience for all types of bonds to the NC Department of Insurance which licenses the Association. They collect that loss experience over years and develop loss costs (a component to the premium end rate that is charged to the purchaser of the bond). Internal operational experiences and profit returns also go into the end rate. This plays a critical role in the surety industry which is a very small line of insurance business. The mortgage broker bond rate is a country-wide rate which is 1-2% of the bond amount. A surety bond is a type of insurance that underwrites a two-party agreement by which a party owes an obligation to another. It provides financial protection and prequalification, and can be further defined as to assessing the risk of the bond principal, the size of the obligation, terms of payment and duration of the surety bond. He noted that North Carolina's requirement for bond amounts is relatively high compared to surrounding states for both broker and lender. This has consequences in terms of the underwriting, the extent of the availability of the bond and the cost of the bond. Mr. Duke noted some aspects for the committee to look at that factor into the underwriting of the bond include the five year tail, the financial obligation of the bond, compliance with the statute and a waiver for the adverse pool of applicants. Regarding the five year tail, Representative Szoka asked if there had been a comparison of the rates of surrounding states. Mr. Duke responded the Association had not done a comparison but rates are very much the same; the availability is more of a concern than the pricing of the bond. Representative Szoka continued by asking if North Carolina had the same amount of bonding companies as surrounding states (regarding the five year tail). Mr. Duke responded there may be fewer companies but not a substantial number, and states look at different thresholds comparative to each other.

After the presentations, Representative Bell opened the meeting to questions and discussion from the Committee Members with a focus on surety bonds. Representative Szoka asked if the NCCOB had ever waived the requirement for bonds for licensees. Deputy Commissioner Molly Sheehan from the NCCOB responded that eight were waived for the

bonding requirement and the eight had met the pre-criteria to be waived. Representative Bell noted a copy of G.S. 53-244.103 regarding the surety bond requirement is in the Member's folder for review (see Attachment B).

Representative Bell asked if anyone in attendance had any questions or comments. Mr. Shawn Barsness of Legacy Home Loans who is a small mortgage broker and operates in four states (Virginia, North Carolina, South Carolina, and Florida) commented that North Carolina has the toughest bond requirements, is more difficult to do business with and would like to see the five year tail reduced. Nathan Batts who represents the NC Bankers Association stated many brokers have good relationships with banks across the State. He is concerned about the bond amounts that weren't adequate to provide coverage of claims that were filed (last bulleted item on page 5 with carryover to page 6, Attachment A). He noted the discussion about ways to simplify the process is appreciated but remember the positive things have been accomplished with the current process. Referring to the item on pages 5-6, Representative Szoka asked about the perspective of the item referenced. Charlie Fields with the NCCOB responded the figure was from one claim, one company. Representative Szoka clarified his question by asking what the total volume was during which year. David Tyndall of Mortgage Choice, Inc. responded the total volume in 2011 was \$2.7 billion for brokers and \$9.9 billion for lenders (see Attachment D in Attachment A). James Glenn with Glenn Eagle Lending Inc. added the total number of units for 2011 was 67,000 units. Referring to Attachment C, (Attachment A), Representative Jordan asked to clarify the amount for 2011. Mr. Fields responded that Representative Szoka's question referred to the annual total volume which is in Attachment D (Attachment A). Representative Jordan stated the total claim amount isn't stated in Attachment C (Attachment A). Mr. Fields responded that the bond claim amount in 2011 which was \$150,000 was the maximum amount that could be claimed with the surety bond. Representative Jordan asked if there were any other claims listed that exceeded or were the same as the surety bond. Mr. Fields responded there were, and noted claims for 2009 were \$50,000 and for 2006 were \$25,000. Representative Jordan asked about the excess amount for each claim listed. Mr. Fields responded the shortages were roughly \$42,000 in 2012, \$2.1 million in 2006 and \$200,000 in 2009. Don Fader SMC Home Finance asked how many customers were adversely affected by the inability for the bond to pay the maximum amount, and which is paid first, civil penalties or the consumer. Mr. Fields replied he would get an answer to the Committee. Al Ripley who is the Director of the Consumer Housing Project of the NC Justice Center commented over the years as problems have occurred in the mortgage sector, the Center liked the current structure, thinks the bonding requirements are in the right place and would agree to increase the tail to 10 years. Representative Szoka asked Mr. Ripley if claims in mortgages were included in mortgage law. Mr. Ripley responded there are certain fiduciary duties a broker has to a client that has a statute of limitation up to ten years, and some aspects regarding the usury law covers the claims made on payments. Representative Jordan asked if there is a statute of limitation that exceeds the tail. Mr. Ripley responded there were cases where this has happened where the entity that made the loan is no longer in existence, and the bond is the only resource the consumer has to file a claim if the bond has expired, the consumer has no recourse. Molly Sheehan from the NCCOB added

the consumer is always reimbursed first before civil penalties are awarded, and under the SAFE Act, Florida doesn't have a surety bond but requires a refund of monies be collected that is set aside. Ellen Harnick with the Center for Responsible Lending and Self Help Credit Union noted the current structure hits the right balance, the cost of the obligations are minimal and keeps the "bad actors" out so the consumer is assured the mortgage broker has been properly vetted. Regarding the screening and vetting process, Mr. Fader commented that North Carolina is fortunate to have one of the finest regulatory agencies in the nation. Secondly, he noted the most compelling reason to maintain the bonds at the current level is because of catastrophic claims. The small independent mortgage professionals are having difficulties staying afloat and a reduction in bonds would help this industry to succeed. Mr. Tyndall presented a document that summarized the information presented in the NCCOB's stakeholders meeting (see Attachment D). From 2006-2012, there were over one million mortgage loan originations, over \$174 billion in volume, and 26 claims on bonds. Only a total of 4 out of the 26 claims exceeded the bonding limit in which the large overage was in civil penalties. He noted that 85% of brokers and 53% for mortgage lenders fall in the bottom two tiers for bonding. North Carolina falls below many states in the MLS region because of the mortgage surety bond requirements. The opportunities aren't as available in North Carolina because the surety entities are less willing to write bonds because of the five year tail. He commented the requirement for record keeping is three years in North Carolina so this has an impact on the five year tail. The proposal submitted from mortgage bankers that represent non-depositories in North Carolina is on the last page of Attachment D. Regarding the proposal, Representative Jordan asked Mr. Tyndall how much would this save for small businesses if the changes went forward. Mr. Tyndall replied it would be 1-2% of the amount of bond level. Mr. Duke cautioned on drawing conclusions between the relationships of rating premiums versus the number of claims. Mr. Batts asked Mr. Duke what the aggregate premiums paid per year for North Carolina; Mr. Duke doesn't have the information available. Mr. Tyndall was able to answer the question, and said there was a difference between the early years of 2005 to 2008 from the latter years of 2009 to 2012 which was attributed to an exodus in the mortgage industry so the premiums collected in the early years were far greater.

After closing remarks, Representative Bell adjourned the meeting at 1:05 p.m.

Representative John R. Bell, IV
Presiding Co-Chair

Susan W. Horne
Committee Clerk